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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matters of	)	
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Access Charge Reform	)	CC Docket No. 96-262
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Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Tariffs Implementing Access Charge Reform	)	CC Docket No. 97-250
	)	
Consumer Federation of America, Petition for Rulemaking	)	RM-9210

SUPPLEMENTAL COMMENTS AND SUBMISSIONS OF U S WEST COMMUNICATIONS, INC.

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SUMMARY

U S WEST Communications, Inc. (U S WEST) hereby submits its supplemental comments and submissions in response to the Federal Communications Commission's ("Commission") Public Notice dated Oct. 5, 1998. U S WEST generally supports the comments and exhibits submitted by the United States Telephone Association ("USTA").

Fundamentally, U S WEST's position is quite simple. Price cap regulation is resulting in dramatically lower access charges to consumers than would have been conceivable had rate of return regulation been retained. Therefore, the Commission should not concede to the demands of industry monoliths such as AT&T/TCG and MCI WorldCom that the price cap bargain be breached by forcibly reducing interstate access rates below what already has been accomplished. If anything, the Commission should take steps to provide the maximum public benefit by reducing the current incumbent local exchange carrier ("LEC") 6.5% X-factor and granting regulatory flexibility and freedom in those markets that are subject to competition.

First, the demands of industry monoliths such as AT&T and MCI WorldCom to raise the X-factor as a means of further driving down interstate access rates are fundamentally flawed. The Commission's price cap regime must provide incumbent LECs with a modicum of stability. Otherwise, regulated carriers do not have the economic incentive to make long-term incentives in technology within their networks. Further, large interexchange carriers ("IXC") are effectively asking the Commission to penalize companies for succeeding under price cap regulation by driving out the inefficiencies that were inherent under rate of return regulation.

The fact that, as demonstrated by a recent USTA study, large IXCs are not passing access charge reductions on to their customers belies their argument that further reductions would produce some kind of public benefit.

As a simple matter of common sense, the 6.5% productivity factor is an unsustainable and probably destructive number. An in-depth review and update of the productivity factor prepared by Dr. Frank Gollop demonstrates that the current X-factor is too high. It is also important to recognize that much of the current growth of incumbent LECs is based on usage sensitive pricing for growth in services which do not exhibit usage sensitive cost characteristics. It should also be self evident that incumbent LECs as a class will not be able to out-produce the entire American economy by a staggering 6.5% per year (or 26% after four years) on a sustained basis.

Second, a number of large IXCs claim that interstate access charges are too high because they exceed their own formulation of forward looking costs. However, prescribing rates based on forward looking costs in a separations driven regulatory environment would be unlawful. Moreover, as documented in the USTA study, the Commission's price cap and access charge structure are resulting in a movement of access charges towards economic costs. Relying on market forces to achieve this objective is most assuredly a better approach than a regulatory effort to pre-determine what those economic costs should be.

Third, the Commission should rapidly adopt the very modest industry deregulation/pricing flexibility schedule. The Commission has recognized that deregulation is appropriate, and indeed preferable, in competitive markets.

U S WEST's experience shows the rapid proliferation of competition in the market for access services nationwide. In fact, U S WEST recently filed a petition seeking regulatory relief from dominant carrier regulation in the Phoenix area market for high capacity access services based on substantial evidence that the market is intensely competitive.

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	)	
Consumer Federation of America, Petition for Rulemaking	)	RM-92110

SUPPLEMENTAL COMMENTS AND SUBMISSIONS OF U S WEST COMMUNICATIONS, INC.

U S WEST Communications, Inc. ("U S WEST") hereby submits its Supplemental Comments and Submissions in the above-captioned dockets. These supplemental comments are prompted by the Federal Communications Commission's ("Commission") Public Notice of Oct. 5, 1998.[1]

The Public Notice seeks further comment and information on three different matters related to access reform:

- What, if any, changes should be made to the incumbent local exchange carrier ("LEC") X-factor (the "productivity factor," pursuant to which the prices of incumbent LECs are currently driven down a minimum of 6.5% per year in real terms).

[1] Public Notice, Commission Asks Parties to Update and Refresh Record for Access Charge Reform and Seeks Comment on Proposals for Access Charge Reform Pricing Flexibility, CC Docket Nos. 96-262, 94-1, 97-250, RM-9210, FCC 98-256, rel. Oct 5, 1998.

- Whether the Commission should prescribe incumbent LEC rates, presumably based on some version of rate of return-based analysis or, perhaps, a forward-looking cost methodology such as the TELRIC method developed in CC Docket No. 96-98.
- How should the Commission proceed with granting additional pricing flexibility to incumbent LECs for their interstate access services, if at all?

U S WEST joins in the comments and exhibits submitted by the United States Telephone Association ("USTA").

Fundamentally, our position is quite simple. Price cap regulation is resulting in dramatically lower access charges to consumers than would have been conceivable had rate of return regulation been retained. Thus, taking the suggestion of industry monoliths such as AT&T and MCI WorldCom that the price cap bargain be breached by the regulator because many incumbent LECs have earned returns over the past years commensurate with their industry counterparts would not only be grossly unfair and of questionable legality, such action would, by destabilizing price cap regulation, create an environment hostile to investment and service quality which would operate contrary to the Commission's entire concept of the public interest. If anything, as is demonstrated in the USTA filing, the current 6.5% X-factor is considerably too high to permit rational long-term investment planning by incumbent LECs and cannot be justified based on updated inputs to the Commission's model which produced the 6.5% X-factor. In point of fact, the X-factor should be phased out and ultimately eliminated. The more open to competition local markets become, the less need or justification there is for any price regulation.

This same analysis leads to the conclusion that "prescription" of a new rate for interstate access by incumbent LECs would be both unlawful and counterproductive. A prescription would, of course, need to be based on a rate of return analysis to have any possibility of surviving legal challenge, because any rate prescription would need to permit affected carriers the full opportunity to recover the costs and investment assigned to the interstate jurisdiction through the separations process. A rate of return-based prescription would, however, seem to be an express betrayal of both the price cap premise and promise. The prescription petitions of the Consumer Federation of America ("CFA") and MCI, based as they are on theoretical costs, simply cannot be sustained if the established prices were not sufficient to recover all interstate costs, plus a reasonable profit.

Finally, it is clearly time for the Commission to take some steps towards granting regulatory flexibility and freedom for at least some incumbent LEC services. There is no good reason to continue dominant carrier regulation of high capacity private line services, data (packet) services, or packaged services offered to larger customers. In fact, it is becoming obvious that in at least some areas where competition seems to be taking hold more slowly, the cause of the absence of meaningful competition can be attributed to a deliberate refusal of large interexchange carriers ("IXC") (who control practically all of the larger competitive LECs at this time) to compete in residential areas, largely as a ruse to delay Bell Operating Company ("BOC") entry into the long distance market. Be that as it may, the record is very clear that much current regulation, including price regulation, is no longer necessary or defensible.

I. THE COMMISSION SHOULD NOT BETRAY THE PRICE CAP BARGAIN BY SEEKING TO FURTHER REDUCE INCUMBENT LEC RATES

The first two issues which the Public Notice addresses both deal with the same series of arguments made by incumbent LEC opponents -- demands that the interstate access prices of incumbent LECs be driven down by regulatory fiat. Several key observations are relevant to demands that the X-factor be increased and that incumbent LEC access rates be reduced below what the X-factor already accomplishes. As these observations have already been made in earlier filings in these dockets, we restate them only briefly.

It must first be remembered that the price cap rules imposed significant new risks on incumbent LECs. The comfortable rate of return regime, whereby incumbent LECs could count on rates linked to investment and cost, was replaced with a structure whereby the incumbent LEC's prices could be driven down each year no matter what happened to investment and cost. The bargain for this greater incumbent LEC risk, which included lower prices for interstate access, was that incumbent LECs who did become more efficient also could become more profitable. Thus, the price cap "bargain" has two sides. Criticizing or penalizing incumbent LECs for becoming overly efficient under price cap regulation would undermine the integrity of the entire structure.

Any Commission action on incumbent LEC rates must recognize the fundamental right of incumbent LECs to recover, or at least to have the opportunity to recover, all of the costs assigned to the interstate jurisdiction via the separations process. Because separations is an artificial process, interstate ratemaking is likewise to a large extent artificial. The Commission is plainly without the power to establish a regulatory structure which denies incumbent LECs the opportunity to recover their separated costs. Thus, while such concepts as forward looking costs have validity as costing models and as proper valuations of economic costs in many circumstances, so long as the separations process remains intact, incumbent LECs must have the opportunity to recover whatever costs the process sends over to the interstate jurisdiction.

Moreover, the price cap regulatory regime must provide incumbent LECs with a modicum of stability or risk undercutting the vitality of local exchange networks and depriving consumers -- particularly those consumers not served by the large competitors -- of both traditional and advanced telecommunications services. The Commission has long recognized that unstable price cap regulation -- particularly price cap regulation that does not provide carriers with the ability to make long-term investment decisions with confidence that regulators would not seek to deprive them of the economic benefits of the investment -- would tend to harm the basic telecommunications network. This is because an overly aggressive price cap regulatory structure would make it economically attractive for a price cap carrier to increase its short term profits by abandoning investment and network maintenance. The fundamental economic driver in a price cap environment must be stability; otherwise regulated carriers are deprived of the economic incentive to deploy the technology within their networks which no one denies would serve the public interest.

In the rate of return environment, inefficient as that regulatory structure was, carriers knew that they would be able to recover their investment plus a reasonable profit by virtue of the regulatory regime itself. This assurance no longer exists under price caps -- carriers now invest with the same hope of earning a profit which motivates investment in other unregulated industries. But if price cap regulation is always hindered by the threat that the regulator may determine that the profit earned by the carrier is "excessive" and warrant for negative price cap adjustments, the regulatory structure itself will harm investment and the public interest. The Commission has already adjusted the price cap formula -- to the detriment of incumbent LECs -- twice during the scant seven years during which price cap regulation has been in effect. Additional tinkering with the X-factor would completely undermine the assumptions on which investments have been made under the current price cap structure and signal to carriers that future investments would be subject to price cap shifts which could make the investments uneconomical.

Indeed, the very notion of assessing the success or failure of a price cap regulatory structure based on reported interstate earnings, as large IXCs such as AT&T and MCI WorldCom have been proposing for some time now, is an extraordinary one. Price cap regulation is intended to drive greater efficiency among regulated carriers by giving them the economic incentive to become more productive. This incentive is the standard motive which has proven to be the engine of the United States economy for well over a century and a half -- the ability to earn a higher profit based on superior performance. To penalize companies for succeeding under price cap regulation -- when they could have avoided these penalties by maintaining the very inefficiencies which price cap regulation was meant to eliminate -- would be a truly bizarre twist of regulatory fate.

The reported rate of return on interstate services for U S WEST for the calendar year 1997 (which included six months with the current X-factor) was 15.39%, something which AT&T and MCI WorldCom have pointed to as meaningful in terms of evaluating whether price cap regulation is "working." We submit that the reported interstate rate of return of a price cap carrier is utterly irrelevant for any purpose. However, several key aspects of this reported rate of return make it clear that, even if an earned rate of return were relevant to price cap review analysis, the interstate rate of return relied on by AT&T and MCI WorldCom would still not be relevant.

The interstate reported rate of return is not directly related to actual company performance, productivity or efficiency, because it is driven to a large extent by the separations process. When U S WEST's overall rate of return (from regulated services) is analyzed, the overall rate of return on rate base (post Part 64 accounting) calculated using the ARMIS reports was 8.9% (1991-1997). This calculation excludes the 1993 curtailment loss and restructure charge. In short, U S WEST is not earning anywhere near the current showing on the FCC Form 492 for regulated interstate services.

In addition, the impact of the separations process on the reported interstate rate of return has been dramatically increased by Internet usage of public switched network. As has been pointed out previously, Internet users have much longer holding times than other network users, and Internet usage has been exploding.[2] U S WEST's local use per line for the years 1991 through 1995 has been consistently in the range of 14,200 and 14,600 minutes of use per line per year. In 1996, this number increased to 15,166 minutes of use per year, and further increased to 16,606 per year in 1997. A very large proportion of this increase is attributed to Internet usage -- we now estimate that the average line used for local calling and Internet access generates 64 minutes of use per day, while the average non-Internet user generates 39 local minutes of use per day.[3] It should be noted that practically all of the incremental usage above 39 local minutes per day is interstate in nature, but is treated as intrastate for separations purposes, and is billed at the flat-rated charges currently available for "local" usage.

Our point here is not to argue the merits of a structure which enables this type of pricing to occur, but rather to observe the significant impact which Internet usage has on the separations process, which in turn is driving the interstate rate of return of all incumbent LECs. Simply stated, Internet usage, which is almost entirely interstate in nature, is driving costs artificially to the intrastate jurisdiction. Because Internet usage is not priced (per governmental force) in an economic manner, it is not bringing with it a commensurate amount of revenue to cover the costs. The result is a mismatch which artificially drives up the interstate reported rate of return, and drives down the intrastate rate of return.

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[2] See, e.g., Comments of U S WEST, Inc. In Response To Notice Of Inquiry Concerning Information Service Providers, CC Docket No. 96-262, et al., filed Mar. 24, 1997 at 15-22 and Exhibit A.

Moreover, the separations process driving the reported interstate rate of return is being skewed by interconnection agreements (whereby competitors purchase network elements which have no attached jurisdiction) and numerous anomalies based simply on the way the separations process works (witness the U S WEST frame relay service where the investment was being driven to the intrastate jurisdiction and the revenues were being assigned to the interstate jurisdiction).[4] Indeed, U S WEST has recommended a total restructure of the separations process to bring it into conformance with modern telecommunications reality.[5]

The reported interstate rate of return also is based on the artificial depreciation rates which have produced the current reserve deficiency. If U S WEST's depreciation rates were set at economic levels, its reported interstate rate of return would be considerably lower. U S WEST's total reserve deficiency, assuming a three-year amortization, is $587.8 million per year. U S WEST's interstate reserve deficiency is $123.1 million per year, assuming the same three-year amortization. Overlaying this reserve deficiency on the 1997 reported results yields a 13.65% interstate rate of return, significantly below the 1997 reported rate of return.

Finally, an exhibit submitted by USTA and prepared by the National Economic Research Associates entitled "AT&T, MCI and Sprint Failed to Pass

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[3] This number is based on an assumed 25% Internet penetration.

[4] Petition of U S WEST Communications, Inc. for Waiver, filed May 16, 1997.

[5] Comments of U S WEST, Inc., CC Docket No. 80-286, filed Dec. 10, 1997.

Through in 1998 Interstate Access Charge Reductions to Consumers," (Brandon and Taylor, October 16, 1998) ("NERA Study") documents what most have already either known or intuited -- that the large IXCs are not passing access charge reductions on to their customers. By itself, this phenomenon does not really prove anything -- U S WEST does not suggest that the Commission regulate IXC prices in order to effectuate such a result. However, there are several key conclusions which must be drawn from the fact that access charge reductions are not being passed on to consumers.

First, many IXCs have claimed in the past, and no doubt will continue to claim, that reduction of access prices, even below the level necessary to enable incumbent LECs to continue to invest in their own services or infrastructure, is really some kind of public benefit which should redound to the overall good of consumers. In point of fact, what the IXCs are looking for is a government-mandated hand-out which they plan to keep.

Second, the fact that cost reductions are not being passed on to IXC customers really belies to at least some extent the assumption that the IXC market is competitive, or at least as competitive as many IXCs would like us to believe. The fact that all IXCs receive an input cost reduction, and all IXCs simply pocket this cost reduction as increased profit, is not behavior which would be generally perceived in a robustly competitive market.

Thus, significant skepticism should greet expected promises by IXCs in this docket to pass additional access rate reductions on to consumers.

A. The X-factor Should Be Reduced

By all meaningful accounts, price cap regulation is working, at least in terms of providing a superior alternative to rate of return regulation. The prices of incumbent LEC interstate services are considerably lower than would have been the case had rate base regulation been retained. Yet calls persist from various quarters to the effect that the X-factor, which is an artificial device which drives incumbent LEC prices down by real terms by 6.5% per year (a stunning 26% over four years) should be increased, and that incumbent LEC prices should be further reduced. Aside from the fact that such action would be destructive and illegal, we offer the following observations.

The X-factor was developed based on incumbent LEC productivity analysis, not rate of return analysis (a determination which was, of course, proper). Adjusting the X-factor based on rate of return analysis would be logically unsustainable.

USTA commissioned Dr. Frank Gollop to review the incumbent LEC productivity analysis conducted by the Commission in establishing the current X-factor of 6.5% for the five-year average from 1993 to 1997, but utilizing more current data. Using the Commission's methodology, a proper X-factor using current data would be 4.38% for the five-year average from 1993 to 1997. This figure represents the upper limit of a lawful X-factor.

Dr. Gollop also conducted an in-depth review of the TFP model submitted by USTA in this Docket entitled "Technical Report; Replication and Update of the X-Factor Constructed Under FCC Rules," submitted by USTA in this docket on

October 22, 1998. This productivity review, which we submit is a far more accurate reflection of realistic productivity numbers of incumbent LECs during this period, would produce an X-factor of no more than 3%.

It is also necessary to recognize that the ongoing access charge restructure significantly reduces the ability of an incumbent LEC to maintain productivity gains at the level on which the current X-factor is based. Much of the current productivity growth of incumbent LECs is based on usage sensitive pricing for growth in services which do not exhibit usage sensitive cost characteristics. Access restructure is changing this model, and the Commission must not assume that productivity gains demonstrated in, and often caused by, a prior regulatory structure will continue under the new access rules.

In reviewing the productivity numbers being thrown around in these dockets, a dash of common sense might also be useful. It is self evident that incumbent LECs as a class, so often referred to by their opponents as monopolistic, inefficient dinosaurs, cannot also be able to out-produce the entire American economy by a staggering 6.5% per year -- certainly not on a sustained basis. The 6.5% X-factor must, as a matter of economic necessity, dry up incumbent LEC investment, particularly in those less profitable areas where competitors choose not to serve. As a simple matter of common sense, the 6.5% X-factor is unsustainable and probably destructive.

B. <u>Access Rates Should Not Be Prescribed</u>

As a companion to the assertion by various incumbent LEC opponents that the productivity factor should be increased, a variety of entities have claimed that access rates should be prescribed, generally on some variant of forward-looking costs.[6] The predicate for these demands is pretty much the same as the one for increasing the X-factor -- these entities proclaim that access prices are too high.

However, the basis for the claim is in the realm of fantasy -- these parties claim that interstate access prices are too high because they exceed their own formulation of forward-looking costs.[7] Several brief observations are appropriate.

As noted above, prescribing rates based of forward-looking costs in a separations-driven regulatory environment would be in violation of the law. U S WEST has invested in its network, and its network exists as a physical reality -- although it is often under-depreciated because of regulatory decisions. For the Commission to make a determination that U S WEST would need to price its network based on the projected cost of constructing a future hypothetical network, ignoring what it actually invested in this construction of its current network, would most certainly run afoul of the Communications Act and the Constitution. No matter what one thinks of forward-looking cost methodology of any nature (including the Commission's own TELRIC methodology) as a method for determining economic costs, the Commission is utterly without power to use such methodology to deprive U S WEST of the ability to recover its investments and costs as assigned to the interstate jurisdiction through the separations process.

Moreover, as is documented in the USTA comments referring to the NERA

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[6] Consumer Federation of America, et al., Petition for Rulemaking, Rm-9210, filed Dec. 9, 1997.

[7] Id.

Study, the price cap and access charge structure, the anticipated universal service fund rules, and competition are resulting in a movement of access rates towards economic costs. Indeed, as USTA documents, access charges are declining dramatically, a phenomenon which is attributable both to the Commission's rules and to the necessity for incumbent LECs to prepare for market competition. While U S WEST may disagree with the Commission in details, the concept that a regulatory structure which permits access prices to move towards economic costs based on market forces is most assuredly a better approach than a regulatory effort to pre-determine what those economic costs should be.

II. THE COMMISSION SHOULD RAPIDLY ADOPT THE VERY MODEST INDUSTRY DEREGULATION/PRICING FLEXIBILITY PLAN

U S WEST supports the industry deregulation/pricing flexibility proposal submitted by USTA in its comments. Under this plan, the first phase of deregulation would be triggered by a state-approved interconnection agreement and evidence that customers are utilizing alternative providers. Once these criteria area satisfied, no public interest or cost showing would be required for new services, Part 69 codification would be eliminated, and price deaveraging, volume and term pricing, contract tariffs and promotional pricing would be allowed. This relief appropriately moves toward elimination of asymmetrical regulation, which is extremely harmful in a competitive environment. The second phase of deregulation would be triggered by a showing that 25 percent of an incumbent LEC's demand (by wire center) is addressable by competitors and customers are utilizing alternative providers. Upon such showings, incumbent LECs would be permitted to simplify the price cap basket structure and the services which meet the trigger would be subject to a reduced productivity factor. In the final phase of deregulation, where at least 75 percent of an incumbent LEC's demand (by wire center) is addressable and customers are utilizing alternative providers, the services would be removed from price cap regulation.

This industry proposal is consistent with the Commission's "market-based approach" to reforming access charges. As the Commission recognized,

> Competitive markets are superior mechanisms for protecting consumers by ensuring that goods and services are provided to consumers in the most efficient manner possible and at prices that reflect the cost of production. <u>Accordingly, where competition develops it should be relied upon as much as possible to protect consumers and the public interest.</u> In addition, using a market-based approach should minimize the potential that regulation will create and maintain distortions in the investment decisions of competitors as they enter local telecommunications markets.[8]

Fundamentally, the Commission's approach necessitates that, where competition exists, government regulation should be removed.

U S WEST's own experience proves that there is intense competition in the market for access services. Indeed, U S WEST recently filed a petition asking the Commission to forbear from dominant carrier regulation of its high capacity access services in the Phoenix area. The petition is supported by compelling evidence from resellers and five established facilities based competitors, including the combined AT&T/TCG and MCI WorldCom companies. A copy of U S WEST's petition,

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[8] <u>In the Matter of Access Charge Reform</u>, <u>First Report and Order</u>, 12 FCC Rcd. 15982, 16094 ¶ 263 (1997) (emphasis added), <u>aff'd sub nom.</u> <u>Southwestern Bell Tel. Co. v. FCC</u>, (8th Cir., Aug. 19, 1998).

including the attached market study, engineering report and economic analysis, is attached for inclusion in this proceeding.[9]

Following the approach that the Commission used to assess market power in the AT&T non-dominant proceeding and other proceedings, the noted economists Alfred E. Kahn and Timothy J. Tardiff conclude that U S WEST lacks market power in the Phoenix area market for high capacity access services. First, U S WEST has a steadily declining market share. The market analysis conducted by Quality Strategies demonstrates that competitive providers currently have more than 70 percent of the retail market for high capacity services. Moreover, it is important to note that competitive providers' market share has been growing even more rapidly than the rapid growth in the demand for high capacity access services in the Phoenix area. Perhaps the most important trend statistic is the fact that, between the second and fourth quarter of 1997, competitive providers captured about half of the growth in the demand for these services.

Second, there is high demand and supply elasticity. The customers that tend to purchase access facilities, including business governmental entities and other carriers, are highly sensitive to price and other service characteristics. In addition, competitive providers have deployed more than 800 miles of optical fiber in the Phoenix MSA. These extensive fiber backbone networks could handle all of U S WEST's end user and transport traffic at less than eight percent capacity. As the report prepared by POWER Engineers, Inc. shows, competitive providers would

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[9] See Exhibit A.

not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current demand for high capacity access services.[10]

Third, U S WEST does not enjoy an advantage in terms of its costs, structures, size and resource. To the contrary, the combined AT&T/TCG and MCI WorldCom companies have a significant advantage in terms of scale economies and access to capital, not to mention the advantage of being able to provide interLATA services.

In light of U S WEST's lack of market power, Kahn and Tardiff conclude that competition, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of service. Not only is such regulation unnecessary, but it harms the public interest by dampening the incentive of all competitors to innovate and reduce prices.

The competitive environment in the State of Nebraska, as outlined in the attached testimony of Professor Robert G. Harris, provides further support for the conclusion that competition in the market for access services also exists outside of the largest metropolitan areas.[11] Professor Harris notes that three competitive LECs have entered the local exchange market in the Omaha metropolitan area, and two companies are serving or have announced plans to serve businesses in smaller communities. These include the following:

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[10] Exhibit A at Attachment B.

[11] See Exhibit B.

- Cox Communications, the cable provider in the Omaha metropolitan area, began offering local telephone service to residential customers in parts of Omaha in December 1997 and plans to roll out telephony offerings to its entire cable service area in Omaha by the end of 1998.

- TCG, the large competitive LEC recently purchased by AT&T, constructed a 200-mile network in Omaha in 1993 to provide dedicated access and private line services to large business customers.

- Aliant, an independent incumbent LEC, began offering competitive local telephone service in June 1997. The company has been targeting its existing cellular subscribers, as well as PBX users in businesses and apartment buildings.

- FirstTel, a subsidiary of Advanced Communications Group, is currently reselling local exchange service in the more rural communities of Nebraska.

- Nebraska Technology and Telecommunications is a new entrant formed by eight small existing independent local telephone companies in Nebraska. The company is targeting business customers in small communities with populations greater than 1,000 and plans to combine local telephony (via resale initially) with telecommunications management and consulting services.

While competitive entry in Nebraska is focused on Omaha (where the majority of U S WEST's customers are located), limited entry in the rural communities of Nebraska also is occurring.

As U S WEST's experience demonstrates, competition in the market for access services is developing rapidly, and is already full-blown in many markets. Continuing to maintain asymmetrical regulation of incumbent LECs in the face of this competitive environment imposes significant social costs deprives consumers of the benefits of competition. Thus, it makes good sense for the Commission to deregulate upon a showing that objective competitive measures are satisfied.

Respectfully submitted,

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October 26, 1998

EXHIBIT A

Stamp + Return

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)
	)
Petition of U S WEST Communications, Inc.	)
for Forbearance from Regulation as a	)
Dominant Carrier in the Phoenix, Arizona	)
MSA	)

PETITION OF U S WEST COMMUNICATIONS, INC. FOR FORBEARANCE

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SUMMARY

U S WEST Communications, Inc. ("U S WEST"), pursuant to Section 10 of the Telecommunications Act of 1996 ("1996 Act"), hereby submits this Petition requesting that the Federal Communications Commission ("Commission") exercise its authority to forbear from regulating U S WEST as a dominant carrier in the provision of high capacity services in the Phoenix, Arizona Metropolitan Statistical Area ("MSA").

In its Petition, U S WEST demonstrates that the Phoenix area market for high capacity services is robustly competitive. U S WEST faces intense competition from both resellers and five established facilities-based competitors with substantial resources and extensive fiber networks. These established companies, which include the combined AT&T/TCG and MCI/MFS WorldCom companies, have access to financial resources equal to or greater than U S WEST's with which to fund expansion of their networks.

Following the approach that the Commission used to assess market power in the AT&T non-dominant proceeding and other proceedings, Professors Alfred E. Kahn and Timothy J. Tardiff conclude that U S WEST lacks market power in the Phoenix area market for high capacity services. First, U S WEST has a steadily declining market share. The attached market analysis conducted by Quality Strategies demonstrates that competitive providers have captured more than 70 percent of the retail market for high capacity services. Moreover, it is important to note that competitive providers' market share has been growing even more rapidly

than the rapid growth in the demand for high capacity services in the Phoenix area. Perhaps the most important trend statistic is the fact that, between the second and fourth quarter of 1997, competitive providers captured about half of the growth in demand for high capacity services.

Second, there is high demand elasticity. The customers that tend to purchase high capacity facilities – medium to large businesses, governmental entities and other carriers – are highly sensitive to price and other service characteristics. The ability of U S WEST's largest carrier customers to migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability.

Third, there is high supply elasticity. Competitive providers have deployed more than 800 route miles of optical fiber in the Phoenix MSA. These extensive fiber backbone networks could handle all of U S WEST's end user and transport traffic at less than eight percent capacity. A majority of U S WEST's current high capacity demand is located within 100 feet of the competitive providers' networks, which means that it could be absorbed almost immediately at minimal cost. Moreover, as the attached report prepared by POWER Engineers, Inc. demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand. In addition, the impressive growth of competitive providers' market share demonstrates that the cost of entry is not prohibitive.

Fourth, U S WEST does not enjoy an advantage in terms of its costs, structure, size and resources. Indeed, the combined A&T/TCG and MCI/MFS WorldCom companies have a significant advantage in terms of scale economies and access to capital, not to mention the advantage of being able to provide interLATA services. The presence of competitive activity in the market while prices are dropping steadily is a strong indication that U S WEST does not have an insurmountable cost advantage in the market.

In light of U S WEST's lack of market power, Kahn and Tardiff conclude that competition, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of service. Therefore, U S WEST seeks forbearance from various dominant carrier regulations, including the requirement that U S WEST file tariffs on up to 15-days notice with cost support, price cap and rate of return regulation, and the requirement that U S WEST charge averaged rates throughout the State of Arizona (i.e., the Arizona study area).

U S WEST's Petition satisfies the three criteria of Section 10. First, because U S WEST lacks market power, dominant carrier regulation is not necessary to ensure that its rates and practices are just, reasonable and not unreasonably discriminatory. Moreover, other regulations (such as Sections 201 and 202 of the Communications Act of 1934, as amended) are sufficient to ensure that U S WEST does not attempt to charge unreasonable rates. Second, for these same reasons, dominant carrier regulation is not necessary to protect consumers. Third, forbearance from applying dominant carrier regulation to U S WEST's high capacity services is consistent with the public interest.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)
	)
Petition of U S WEST Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	))))

PETITION OF U S WEST COMMUNICATIONS, INC. FOR FORBEARANCE

U S WEST Communications, Inc. ("U S WEST"), through counsel and pursuant to Section 10 of the Telecommunications Act of 1996 ("1996 Act"),[1] hereby submits this Petition requesting that the Federal Communications Commission ("Commission") exercise its authority to forbear from regulating U S WEST as a dominant carrier in the provision of high capacity services[2] in the Phoenix, Arizona Metropolitan Statistical Area ("MSA"). This includes forbearance from enforcing the Commission's Part 61 tariff rules as they apply to dominant carriers and any other rules affecting high capacity services which result in different regulatory treatment for dominant and non-dominant carriers.

U S WEST's Petition is limited in scope both geographically and the services covered by it. Furthermore, it does not present any novel questions of law or fact which might prolong the

[1] 47 U.S.C. § 160.

[2] Specifically, U S WEST seeks regulatory relief for special access and dedicated transport for switched access at DS1 and higher transmission levels (e.g., DS1, DS3 and OCn). No relief is sought for other interstate services, such as switched access and special access and dedicated transport at DS0 and voice grade transmission levels.

Commission's analysis. Therefore, U S WEST requests that the Commission treat this Petition in an expedited manner in order to bring the full benefits of competition to the Phoenix area market at the earliest possible date.[3]

I. INTRODUCTION

One of the key pro-competitive provisions Congress included in the 1996 Act is Section 10, which requires the Commission to forbear from applying any regulation or provision of the Act if the Commission determines that: (1) enforcement is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory; (2) enforcement is not necessary to protect consumers; and (3) forbearance is consistent with the public interest.[4] In making the public interest determination, Section 10 requires that the Commission consider whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition.[5] The statutory imperative created by Section 10 reflects Congress's reasoned judgment that competition, not government regulation, should guide companies' behavior in competitive telecommunications markets.

In the sections which follow, U S WEST demonstrates that the market for high capacity services in the Phoenix MSA is robustly competitive. U S WEST faces intense competition from both resellers and five established facilities-based

[3] Under Section 10, in the absence of an extension, the Commission has one year to act on a forbearance petition before it is deemed to be granted. 47 U.S.C. § 160(c).

[4] 47 U.S.C. § 160(a)(1)-(3).

[5] 47 U.S.C. § 160(b).

competitors with substantial resources and extensive fiber networks. These established companies – Electric Lightwave, Inc. ("ELI"), GST Telecommunications, Inc. ("GST"), MCI Telecommunications Corporation ("MCI"), MFS WorldCom and Teleport Communications Group ("TCG") – have access to financial resources equal to or greater than U S WEST's with which to fund expansion of their networks. Equally as important, the recently completed merger of TCG with AT&T Corp. ("AT&T"), and the pending merger of MCI with MFS WorldCom, will result in the two largest purchasers of high capacity services in Phoenix (AT&T and MCI) having their own competitive fiber networks. U S WEST already is experiencing the effects of these mergers, as significant portions of these customers' high capacity services have been migrated to the affiliated fiber networks.[6]

U S WEST's steadily declining market share for high capacity services in the Phoenix market supports the finding that U S WEST lacks market power. The attached market analysis conducted by Quality Strategies shows that competitive providers have captured more than 70 percent of the retail market for high capacity services.[7] This is the most important market share statistic because the retail provider of high capacity services is the party that has the direct relationship with the customer. In fact, the customer may not even be aware of the identity of the

[6] Upon completion of the AT&T/TCG merger, AT&T Chairman Michael Armstrong said "We're reducing our dependence on Bell companies for direct connections to businesses." Armstrong also pledged "substantial resources" to continue building facilities in key markets, and has mentioned $1 billion for TCG's share of continuing AT&T capital expenses. Communications Daily, July 27, 1998.

carrier actually provisioning the underlying high capacity facilities. Therefore, the retail provider has a significant marketing advantage over the facilities provider and, in the case of U S WEST's competitors, the ability to offer a full service package to the customer that includes interLATA voice and data services.

In addition, expansion of competitive providers' business has been even more rapid than the impressive 13 percent growth in the demand for high capacity services in the Phoenix market. During the period from the fourth quarter of 1994 to the fourth quarter of 1997, the competitive providers' market share of the "provider" segment (i.e., high capacity services ultimately purchased by end users) increased from less than six percent to 28 percent.[8] The competitive providers' market share of the "transport" segment (i.e., high capacity services purchased by carriers for transport) also is growing rapidly, increasing from five percent to 16 percent between the second quarter and the fourth quarter of 1997 alone.[9] Perhaps the most significant trend statistic is the fact that, between the second and fourth quarter of 1997, competitive providers captured 54 percent of the growth in demand of the provider segment and 42 percent of the growth in demand of the transport segment.[10] Share of growth is the primary indicator of what a competitor's installed-base market share will look like in the future – and competitive providers

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[7] See Attachment A (Quality Strategies, U S WEST High Capacity Market Study, Phoenix Metropolitan Statistical Area, dated Aug. 7, 1998, at 17 ("Quality Strategies Report")).

[8] Id. at 16.

[9] Id. at 14.

[10] Id. at 15.

in the Phoenix area have captured a majority share of market growth over the past several years.

It also is important to consider the fact that existing competitive fiber networks could absorb all of U S WEST's high capacity traffic at less than eight percent capacity.[11] The only real constraint on competitive providers expanding service to U S WEST's customers is the need to build facilities to connect these sites to their existing fiber backbone networks. In most cases, this is not an issue at all. Approximately 65 percent of U S WEST's current high capacity demand (DS1 equivalents) in the Phoenix area is located within 100 feet of existing competitive provider fiber networks, which means that it is essentially located "on-network." Thus, competitive providers could absorb a majority of U S WEST's high capacity demand almost immediately, incurring only minimal costs.

Moreover, as the attached report prepared by POWER Engineers, Inc. ("PEI") demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand.[12] Specifically, competitive providers in Phoenix can serve the almost 50 percent of U S WEST's high capacity customer locations within 1,000 feet of their existing fiber networks if they invest $45 million,[13] and all of U S WEST's high capacity customer locations within 9,000 feet of their existing fiber networks if

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[11] Id. at 29.

[12] See Attachment B (POWER Engineers, Inc., Phoenix Cost Study & Model, Aug. 13, 1998 ("PEI Study")).

[13] Id. at 3. These locations account for approximately 86% of all U S WEST's current high capacity demand in the Phoenix area.

they invest approximately $127 million.[14] Given that U S WEST's share of the Phoenix area market for high capacity services is worth approximately $50 million on an annual basis and the fact that the market has been growing steadily at about 13 percent annually, it is economically rational to assume that competitive fiber networks would be able to absorb most, if not all, of U S WEST's existing customers within a relatively short period of time.

The noted economists Alfred E. Kahn and Timothy J. Tardiff have analyzed the market share and competitive fiber network data for the Phoenix area high capacity services market following the approach the Commission previously has used to assess market power for other services.[15] They conclude that "the market for high capacity services in the Phoenix area fully exhibits the indicia of competition that the Commission has prescribed."[16] In light of U S WEST's lack of market power, Kahn and Tardiff affirm that competition itself, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of services.

Indeed, Kahn and Tardiff conclude that continuing dominant carrier regulation of U S WEST's high capacity services in this highly competitive

[14] Id. These locations account for approximately 95% of U S WEST's current high capacity demand in the Phoenix area.

[15] See Attachment C (Alfred E. Kahn and Timothy J. Tardiff, Economic Evaluation of High Capacity Competition in Phoenix, Aug. 18, 1998, at 1 ("Kahn and Tardiff Paper")).

[16] Id.

environment would be "anti-competitive and injurious to consumers."[17] U S WEST is the only carrier in the market that is required to file tariffs on up to 15-days notice and provide cost support.[18] Not only does this impose an unnecessary regulatory burden on U S WEST, but it gives competitive providers advance knowledge of U S WEST's rates, thereby providing these competitors with an unfair opportunity to quickly implement a market response before the filed rates can even take effect. U S WEST also is the only carrier that is required to charge uniform rates throughout the entire State of Arizona (i.e., the Arizona study area), which means that U S WEST is prohibited from responding to competitive initiatives of other carriers.[19] The end result is that competitive providers can undercut U S WEST's prices and cherry-pick the most desirable customers. The disparate regulation of U S WEST as compared to every one of its competitors places U S WEST at a severe competitive disadvantage in the high capacity services market in the Phoenix MSA.

U S WEST's Petition seeking relief from dominant carrier regulation in the Phoenix area market for high capacity services satisfies the statutory criteria for forbearance. First, dominant carrier regulation of U S WEST's high capacity

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[17] Id. at 3.

[18] See, generally, 47 C.F.R. §§ 61.38, 61.41-61.49.

[19] 47 C.F.R. § 69.3(e)(7) (access tariffs filed by price cap LECs "shall not contain charges for any access elements that are disaggregated or deaveraged within a study area that is used for purposes of jurisdictional separation"). Although U S WEST is permitted to establish density pricing zones for access elements, pricing for each density pricing zone must be uniform within a study area. 47 C.F.R. § 69.123.

services is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory. U S WEST does not have the power to control price in this market nor the ability to act in a discriminatory manner. Second, because U S WEST cannot control prices or act in a discriminatory manner, the imposition of dominant carrier regulation on U S WEST's high capacity services simply is not needed to protect consumers in the Phoenix MSA. Third, continuing to subject U S WEST's high capacity services in the Phoenix area to dominant carrier regulation deprives customers of the benefits of true competition by imposing unnecessary regulatory costs on U S WEST and hampering its ability to quickly and effectively respond to competitive initiatives. In sum, continued dominant carrier regulation of U S WEST's high capacity services in the Phoenix MSA harms the public interest and contravenes the pro-competitive goals underlying the 1996 Act.[20]

Finally, U S WEST emphasizes that it is not requesting that its high capacity services be deregulated – it is requesting only that the Commission exercise its Section 10 forbearance authority and regulate U S WEST as a non-dominant carrier in the high capacity services market in the Phoenix MSA. As a non-dominant provider, U S WEST should be subject to permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of

[20] Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 230, 104 Congress, 2d Session 113 (1996).

lawfulness and without any cost support.[21] The Commission also should free U S WEST's high capacity services from price cap and rate of return regulation, which are appropriate only for dominant carrier services.[22] Moreover, the Commission should forbear from applying Section 69.3(e)(7) of its rules so that U S WEST can charge deaveraged rates within the Phoenix MSA. The effect of granting U S WEST's Petition would be to place U S WEST on equal footing with all other competitors in the Phoenix area market for high capacity services.

II. U S WEST SHOULD BE DECLARED NON-DOMINANT IN THE PHOENIX MARKET FOR HIGH CAPACITY SERVICES

U S WEST's classification as a dominant carrier in the high capacity services market dates back to 1980, when the Commission found that AT&T, including its 23 associated telephone companies, dominated the telephone market.[23] Since that time, the high capacity services market has evolved from a market containing only a few competitors into a highly competitive market containing many competitors. Further, Congress adopted a number of market-opening requirements as part of the 1996 Act. These statutory requirements have had the effect of accelerating the competition that was already occurring in the high capacity services market and

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[21] In the Matter of Hyperion Telecommunications, Inc. Petition Requesting Forbearance, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 12 FCC Rcd. 8596 (1997) (forbearing from requiring non-incumbent local exchange carrier ("LEC") providers of exchange access services to file tariffs) ("CAP Forbearance Order").

[22] 47 C.F.R. §§ 61.41-61.49; 47 C.F.R. § 65.

[23] In the Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, First Report and Order, 85 F.C.C.2d 1, 22-23 ¶¶ 60-63 (1980).

ensuring that the market remains competitive. By any measure, competitive telecommunications carriers are experiencing phenomenal growth and success in the Phoenix MSA and have evolved into a mature industry.

As demonstrated below, U S WEST cannot exercise market power in the Phoenix area market for high capacity services. If U S WEST were to attempt to raise prices, either directly or through restricting output, its customers would quickly abandon U S WEST for one of the various competitive providers in the market. Yet U S WEST remains subject to the full panoply of dominant carrier regulations while all of its competitors enjoy the benefits of streamlined regulation. The Commission should exercise its Section 10 forbearance authority and regulate U S WEST in a manner commensurate with its non-dominant position in the high capacity services market.

A. Defining The Relevant Product And Geographic Market

The first step in analyzing market power is to determine the relevant product and geographic markets.[24] This approach allows for assessment of the market power of a particular carrier based on unique market situations by recognizing, for example, that "carriers may target particular types of customers, provide specialized services, or control independent facilities in specific geographic areas."[25] In its Petition, U S WEST has carefully limited the scope of relief to the products

[24] In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd. 3271, 3285 ¶ 19 (1995) ("AT&T Reclassification Order").

and geographic area which are shown to be competitive in the attached market analysis and engineering report.

1. High Capacity Services

The Commission has defined a relevant product market as a service or group of services for which there are no close demand substitutes.[26] In accordance with the Commission's analytical framework, U S WEST has defined the relevant product market as dedicated high capacity circuits provisioned at capacities of DS1 and above for purposes of the instant Petition. These high capacity circuits may be used to transmit voice, data, or both, and may utilize either wireline or wireless technology. While high capacity circuits may be provisioned at varying bandwidths using different technologies, they share the characteristic of offering business, government and carrier customers substantial bandwidth on a dedicated basis.

The Kahn and Tardiff Paper confirms that services provided to customers with usage sufficiently great to be economically served with high capacity facilities define the relevant product market.[27] In terms of the standard established by the Merger Guidelines, customers for lower capacity facilities would not shift their

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[25] In the Matter of COMSAT Corporation, File No. 60-SAT-ISP-97; IB Docket No. 98-60; File No. 14-SAT-ISP-97; RM-7913; CC Docket No. 80-634, Order and Notice of Proposed Rulemaking ¶ 27 (1998) ("Comsat Reclassification Order").

[26] Id. ¶ 25 (citing LEC Classification Order ¶¶ 41, 54 (In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd. 15756 (1997) ("LEC Classification Order"))).

[27] Attachment C, Kahn and Tardiff Paper at 3.

demands to high capacity facilities in response to a "small but significant" price increase in their current services, because the monthly cost of hooking them up for high capacity access is as much as six to seven times their current basic monthly charges.[28] Because high capacity access and low capacity access are not substitutable on the demand side, low capacity services are in a separate product market.[29]

2. Geographic Scope of the Market for Dedicated High Capacity Services

As the Commission recently explained, a "relevant geographic market aggregates into one market those consumers with similar choices regarding a particular good or service in the same geographical area."[30] U S WEST's Section 10 Petition seeks regulatory relief only for the Phoenix MSA because within this market there is an identifiable class of competitors providing high capacity services. Kahn and Tardiff note that the geographic scope for high capacity facilities from the supply side is the metropolitan area.[31] A metropolitan area tends to be the area

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[28] Id. at 4 (citing Merger Guidelines).

[29] Id.

[30] Comsat Reclassification Order ¶ 27; see also In the Applications of NYNEX Corporation and Bell Atlantic Corporation For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, Memorandum Opinion and Order, 12 FCC Rcd. 19985, 20016-17 ¶ 54 (defining relevant geographic area as "an area in which all customers in that area will likely face the same competitive alternatives" for a relevant service) ("Bell Atlantic/NYNEX Order").

[31] Attachment C, Kahn and Tardiff Paper at 5. This definition is consistent with the use of the MSA as the relevant geographic market. The U.S. Census Bureau describes the general concept of an MSA as "that of a core area containing a large population nucleus, together with adjacent communities having a high degree of

within which a provider announces the availability of its service and the area within which a provider can expand in a timely fashion to offer services to a growing number of locations.[32] In this case, the PEI Study demonstrates that competitors can economically expand to serve almost half of U S WEST's existing high capacity customer locations in the Phoenix area (representing 86 percent of its existing high capacity demand) within 18 to 24 months.[33]

U S WEST also limits the geographic scope of its Petition so that it covers only that area for which U S WEST has irrefutable evidence of competition. The attached Quality Strategies Report (Attachment A) shows that U S WEST faces intense competition from established facilities-based providers in the provisioning of high capacity services in the Phoenix MSA. In fact, competitive providers have substantial market share and more than sufficient network capacity to absorb U S WEST's existing business should U S WEST attempt to exercise market power. In addition, the PEI Study demonstrates that competitive providers could expand their existing networks at relatively little cost to serve U S WEST's existing high capacity customers in the Phoenix area. Based on this evidence, Kahn and Tardiff conclude that the Phoenix area market for high capacity services is highly

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economic and social integration with that core." http://www.census.gov//population/www/estimates/aboutmetro.htm.

[32] Attachment C, Kahn and Tardiff Paper at 5. That is not to say that competitive providers are limiting their competitive entry to the Phoenix MSA. GST, for example, describes itself as a "super-regional" competitive LEC and is clearly focused on increasing its statewide presence in Arizona. http://www.gstcorp.com/annual97.

[33] Attachment B, PEI Study at 3.

competitive and that U S WEST does not have the ability to exercise market power.[34]

B. The Phoenix Market For High Capacity Services Is Robustly Competitive

In assessing market power, the Commission is guided by well-accepted principles of antitrust analysis to determine whether a carrier is dominant in the relevant product and geographic market.[35] The Commission has relied on several factors as part of this analysis, including: (i) market participants; (ii) market share; (iii) the demand elasticity of customers; (iv) the supply elasticity of the market; and (v) the carrier's cost, structure, size and resources. Assessment of these general characteristics of the Phoenix area market for high capacity services demonstrates that U S WEST cannot exercise market power.

1. Market Participants

The Phoenix market for high capacity services is characterized by a number of established competitors with substantial resources. The following is a brief description of the five facilities-based market participants discussed in the Quality Strategies market analysis:

ELI has over 400 route miles of fiber in the Phoenix area and 30 to 45 buildings on its network.[36] ELI also claims to have invested $37 million in new

[34] Attachment C, Kahn and Tardiff Paper at 20-21.

[35] Comsat Reclassification Order ¶ 67.

[36] Attachment A, Quality Strategies Report at 26.

facilities in Phoenix.[37] Far from being a start-up, ELI is a subsidiary of Citizens Utilities Company, a large utility company and full-service telecommunications services provider.[38]

Moreover, ELI is a rapidly growing company. In 1997 alone, ELI's revenues increased 95 percent, from $31.3 million to $61.1 million. ELI's network services revenue (which includes private line services) increased from $18.7 million in 1996 to $33.5 million in 1997, an increase of 78.9 percent.[39] In addition, ELI's route miles increased from 1,428 to 2,494, an increase of 74.6 percent, and its fiber miles increased from 97,665 miles to 140,812 miles, an increase of 44.2 percent.[40]

GST has approximately 300 route miles of fiber in Arizona, including more than 11 miles of fiber in downtown Phoenix and a long haul fiber link between Phoenix and Tucson.[41] GST has wired 15 to 25 buildings on its network. GST also installed more than 50,000 access lines in 1997 and 16,000 additional access lines in the first quarter of 1998.[42] In the first quarter of 1998, GST acquired a long distance company, Call America Phoenix.[43]

MCI has 20 to 40 route miles of fiber in the Phoenix area and 25 to 35

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[37] http://www.eli.net/phxswitch.html.

[38] http://www.eli.net/history.html. Citizens Utilities had revenues of $1.4 billion in 1997, an increase of 8% over 1996.
http://www.czn.net/PressReleases/pr031298.html.

[39] http://www.eli.net/annual.pdf.

[40] Id.

[41] Attachment A, Quality Strategies Report at 26.

[42] http://www.gstcorp.com/investors/March10k.html.

[43] http.//www.gstcorp.com/press/gen86.html.

buildings on its network.[44] The merger of MCI and MFS WorldCom (see below) is currently pending.

MFS WorldCom has 75 route miles of fiber in the Phoenix area and more than 50 buildings on its network.[45] The merger of MFS WorldCom and MCI (see above) is currently pending.

TCG has over 300 route miles in the Phoenix area and more than 150 buildings on its network.[46] The merger of TCG and AT&T was recently completed. AT&T already has begun the process of migrating all of its dedicated high capacity traffic from U S WEST to TCG.

Clearly, none of these providers of high capacity services can be classified as "start-up" companies. According to Quality Strategies, ELI and TCG entered the market in 1994, MFS WorldCom entered the market in 1995, MCI entered the market in 1996 and GST entered the market in 1997. Further, these companies have access to financial resources equal to or greater than U S WEST's that can be used to fund expansion of their networks serving Phoenix customers of high capacity services. For example, in the past two years, WorldCom acquired two competitive providers, MFS and Brooks Fiber, for a combined price of $16.4 billion – an amount almost identical to what SBC paid to acquire Pacific Telesis. The combined MCI and MFS WorldCom company will have 22 million customers and

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[44] Attachment A, Quality Strategies Report at 25.

[45] Id.

[46] Id.

annual revenues of $32 million in 1998.[47] Similarly, AT&T recently acquired TCG at a cost of $11.3 billion and announced its intention to acquire TCI at a cost of $48 billion. The sheer size of the combined AT&T/TCG and MCI/MFS WorldCom companies dwarfs U S WEST.

Equally as important, the recently completed merger of TCG with AT&T, and the pending merger of MCI with MFS WorldCom, will result in the largest purchasers of high capacity services in Phoenix having their own competitive fiber networks. This is a significant development, given that AT&T/TCG and MCI/MFS WorldCom account for approximately half of U S WEST's high capacity businesses in the Phoenix MSA. In fact, U S WEST already is experiencing the effects of these mergers, as significant portions of these customers' high capacity services have been migrated to the affiliated competitive fiber networks. Kahn and Tardiff observe that "[i]t would be difficult to conceive of a more substantial consequent diminution of whatever market power [U S WEST] might previously have enjoyed."[48]

U S WEST's experience with AT&T is illustrative. AT&T began migrating circuits from U S WEST to competitive provider facilities during the third quarter of 1997 and since then has disconnected a majority of its U S WEST-provided circuits and migrated them to alternative providers. Now that AT&T has completed its merger with TCG, AT&T has pledged to further reduce its dependence on

[47] http://investor.mci.com/merger_overview/merger2.htm.

[48] Attachment C, Kahn and Tardiff Paper at 6.

U S WEST and other Bell companies and to commit "substantial resources" to continue building TCG facilities.[49]

In addition to giving AT&T and MCI access to their own high capacity facilities, the consolidations of AT&T and MCI with facilities-based access providers will result in the merged companies now competing head-to-head with U S WEST in the Phoenix area market for high capacity services. Therefore, AT&T and MCI have an incentive to oppose U S WEST's Petition purely for their own business purposes.

2. Market Share

U S WEST's steadily declining market share for high capacity services in the Phoenix MSA supports the conclusion that U S WEST lacks market power.[50] Quality Strategies uses DS1 equivalents as the basis for its market share calculations because DS1 bandwidth is deemed the baseline for the high capacity services market.[51] As discussed above, the high capacity services market encompasses both voice and data traffic, and wireline and wireless technologies. For analytical purposes, Quality Strategies describes the Phoenix area market for high capacity services as a three-tier market, with U S WEST and other providers selling services to end users, resellers and other carriers for transport purposes.[52] As depicted below, this market can be sub-divided based on who high capacity

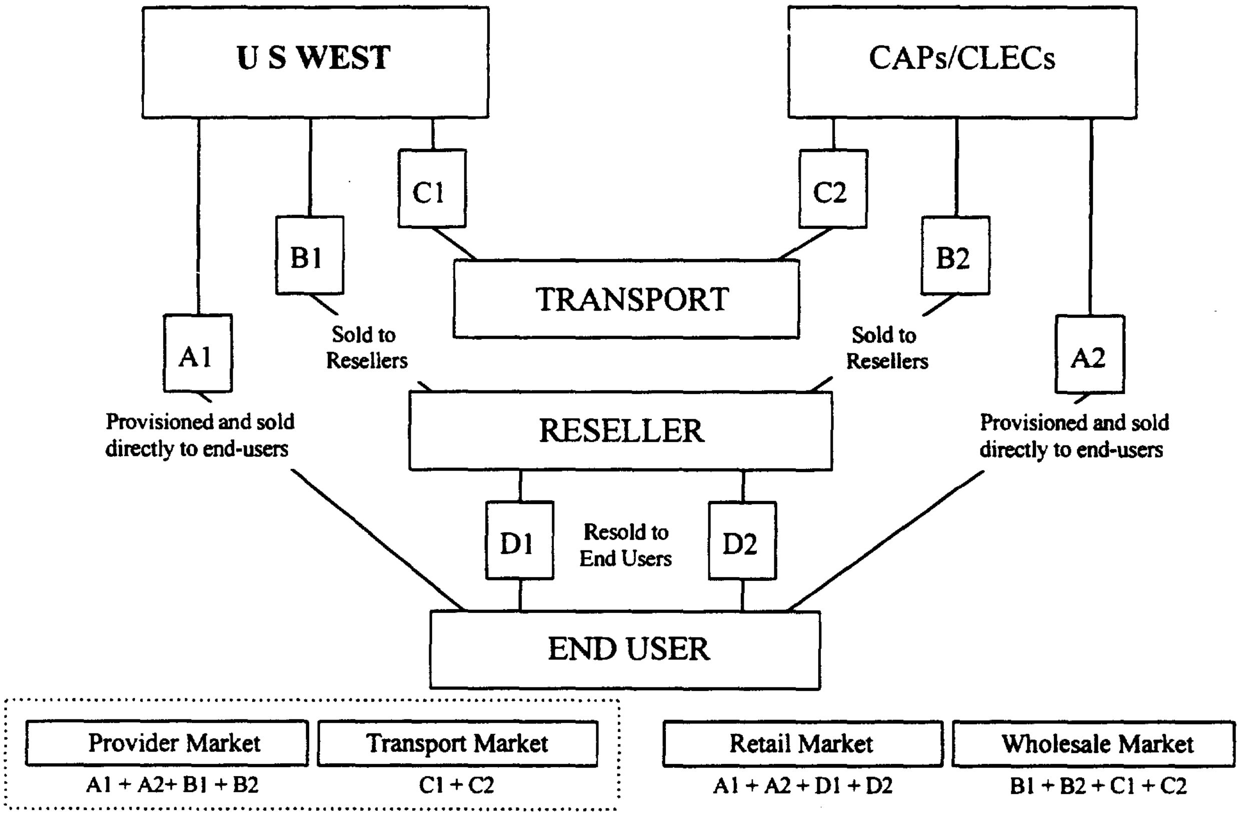
[49] Communications Daily, July 27, 1998.

[50] See AT&T Reclassification Order, 11 FCC Rcd. at 3307 ¶ 67.

[51] Attachment A, Qualities Strategies Report at 35.

[52] Id. at 9-10.

services are sold to – retail and wholesale segments – versus who is ultimately using the underlying facilities – the "provider" and "transport" segments.[53]



The attached market analysis conducted by Quality Strategies shows that competitive providers have captured more than 70 percent of the retail market for high capacity services.[54] This is the most important market share statistic because it identifies the carrier that has the direct account relationship with the customer. In fact, the customer may not even be aware of the identity of the carrier actually provisioning the underlying high capacity facilities. Therefore, the retail services provider has a significant marketing advantage over U S WEST when it is only the

[53] Id.

[54] Id. at 17. The combined AT&T/TCG and MCI/MFS WorldCom companies comprise over 50% of the retail market. Id.

facilities provider. For all competitors in the Phoenix MSA other than U S WEST, the retail service provider can take advantage of its relationship with the customer to offer a full service package which includes interLATA voice and data services.

The Commission has acknowledged the fact that competitive entry of resellers, some of which may grow to become regional or even national facilities-based competitors, puts downward pressure on prices.[55] In its recent decision denying Personal Communications Industry Association's petition for forbearance from enforcing the resale rule as applied to PCS providers, the Commission stated that resellers exert downward pressure on rates through their ability to purchase services at high volume rates and pass through those savings to their customers.[56] The Commission also noted that resellers are able to offer their customers packages of services, some or all of which may be obtained from other providers, thereby enabling resellers to tailor service packages to meet each customer's particular mix of needs.[57] As discussed above, resellers of high capacity services enjoy a significant competitive advantage over U S WEST because of their ability to offer a full service package that includes interLATA services.

Moreover, expansion of competitive providers' business has been even more rapid than the impressive 13 percent growth in the demand for high capacity

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[55] AT&T Reclassification Order at 3304 ¶ 61; In the Matter of Personal Communications Industry Association's Broadband Personal Communications Services Alliance's Petition for Forbearance for Broadband Personal Communications Services, Memorandum Opinion and Order and Notice of Proposed Rulemaking, FCC 98-134, ¶ 35, rel. July 2, 1998 ("PCIA Forbearance Order").

[56] Id.

[57] Id.

services in the Phoenix market.[58] During the period from the fourth quarter of 1994 to the fourth quarter of 1997, the competitive providers' market share of the provider segment (i.e., high capacity services ultimately purchased by end users) increased from less than six percent to 28 percent.[59] The competitive providers' market share of the transport segment (i.e., high capacity services purchased by carriers for transport) also is growing rapidly, increasing from five percent to 16 percent between the second quarter and the fourth quarter of 1997 alone.[60] Perhaps the most significant trend statistic is the fact that, between the second and fourth quarters of 1997, competitive providers captured 54 percent of the growth in demand of the provider segment and 42 percent of the growth in demand of the transport segment.[61] Share of growth is the primary indicator of what a competitor's installed-base market share will look like in the future – and competitive providers in the Phoenix MSA have captured a majority share of market growth over the past several years.[62]

U S WEST's rapid reduction in market share is largely the result of facilities build-out on the part of competitive providers in the Phoenix area and their focus on the large business market. U S WEST's share of the facilities-provider market segment is likely to decrease rapidly as customers, particularly the largest carrier

[58] Attachment C, Kahn and Tardiff Paper at 7. With this rate of growth, demand for high capacity services will double in about 5 1/2 years.

[59] Attachment A, Quality Strategies Report at 16.

[60] Id. at 14.

[61] Id. at 15.

[62] Id. at 7.

customers, migrate traffic onto their own fiber networks.[63] As discussed above, U S WEST already is feeling the impact of this migration. Kahn and Tardiff also assert that the recent strong growth in competitive provider market share is likely to continue, and may even accelerate, given the rapid growth of competitive provider market share nationwide.[64] They note that, during the first quarter of 1998, competitive providers added more business lines nationwide than the Regional Bell Operating Companies ("RBOC").[65]

Kahn and Tardiff compare the Phoenix area market share information with the situation the Commission considered when it granted AT&T non-dominant status for interstate long distance. While U S WEST's overall share of the Phoenix area market for high capacity services is higher than AT&T's share of the long distance market when the Commission found AT&T to be non-dominant (77 percent compared to 60 percent), U S WEST's market share of the retail segment is much lower than AT&T's.[66] According to Kahn and Tardiff, "we doubt there would be economists prepared to refer to a firm with 30 percent of the retail market as 'dominant.'"[67] Moreover, for both the retail and wholesale market segments, competitive providers' shares and volumes of the high capacity business in the

[63] Id. at 31.

[64] Attachment C, Kahn and Tardiff Paper at 7.

[65] Id. at 8 (citing Statement of Heather Gold, FCC En Banc on State of Local Competition, January 29, 1998 and Salomon Smith Barney "CLECs Surpass Bells in Net Business Line Additions for the First Time," May 6, 1998).

[66] Id.

[67] Id.

Phoenix area are growing at a considerably more rapid rate than were AT&T's competitors' shares and volumes of the long distance business.[68] In their study, Kahn and Tardiff's state that "the consensus of economic opinion would be to place greater emphasis on changes in market shares over time and shares in incremental business than their absolute levels."[69] Accordingly, their conclusion is that U S WEST has a much stronger case for claiming a lack of market power in the Phoenix area market for high capacity services than did AT&T.[70]

3. Demand Elasticity

Demand elasticity refers to the willingness and ability of a carrier's customers to switch to a competitive provider, or to otherwise change the amount of services they purchase from the carrier in response to a change in the price or quality of the services. High demand elasticity indicates that customers are willing and able to switch to another service provider in order to obtain price reductions or desired features. It also indicates that the particular service market is subject to competition.[71]

In granting non-dominant status to AT&T, the Commission observed that the demands of business customers are highly elastic because they are sophisticated buyers who typically receive and consider alternative proposals from several

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[68] Id.

[69] Id.

[70] Id. at 9.

[71] Comsat Reclassification Order ¶ 71.

vendors.[72] They also are likely to engage in long-term planning and ordering.[73] The Commission's observation with respect to long distance services clearly applies with at least as much force to the segment of the business customer market that purchases high capacity services and facilities – medium to large business customers, governmental entities and other carriers.[74]

In support of their conclusion, Kahn and Tardiff reference the economic analysis prepared by Professor Michael Porter that AT&T submitted with its request for non-dominant status.[75] Porter found that business customers have considerable negotiating power because of their sophisticated knowledge of telecommunications, their use of outside network consultants, and their ability to provision their own network facilities. Kahn and Tardiff conclude that these factors "are even more powerful in the case of high capacity services" because of the fact that the primary users of these services – other carriers – have both the incentive and the ability to drive a hard bargain for good prices and levels of service by the threat of going elsewhere.[76] The ability of U S WEST's largest carrier customers to

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[72] AT&T Reclassification Order, 11 FCC Rcd. at 3306 ¶ 65.

[73] Comsat Reclassification Order ¶ 72.

[74] Attachment C, Kahn and Tardiff Paper at 9.

[75] Id. at 10 (citing Michael E. Porter, Competition in the Long-Distance Telecommunications Market, September 1993). Kahn and Tardiff note that the Commission cited the Porter Study when concluding that demand elasticity considerations supported the conclusion that AT&T was non-dominant in the long distance market. Id.

[76] Id.

migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability in the marketplace.

As Kahn and Tardiff note, these demand elasticity factors are further reinforced by the already high market share U S WEST's competitors have in the retail segment of the Phoenix area market for high capacity services and the rapid growth of the competitors' market share in the provider and transport segments of the market.[77] Given that the actual provider of the underlying high capacity facilities is often unknown to the end-user customer, U S WEST's retail competitors can take advantage of their customer relationships to become the customer's facilities provider and to acquire additional business.[78] Moreover, so long as U S WEST remains subject to the prohibition in offering interLATA services, the ability of competitive providers to offer a complete package of telecommunications services which includes interLATA voice and data services gives them a "great advantage" over U S WEST in the marketplace.[79]

4. Supply Elasticity

Supply elasticity refers to the ability of suppliers in a given market to increase the quantity of services supplied in response to an increase in price. There are two factors that determine supply elasticities in the market. The first is the supply capacity of existing competitors, because supply elasticities tend to be high if existing competitors have or can easily acquire additional capacity in a relatively

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[77] Id.

[78] Id.

[79] Id. at 11.

short time period.[80] The second factor is the existence of low barriers to entry, because supply elasticities tend to be high if new suppliers can enter the market relatively easily and add to existing capacity.

Quality Strategies has determined that U S WEST's competitors have more than sufficient readily available excess capacity to constrain U S WEST's pricing behavior. As a group, these five facilities-based competitors have installed more than 800 route miles of optical fiber in the Phoenix MSA, typically deploying cable consisting of 144 individual fiber elements along the network backbone.[81] With current technology, these competitive fiber networks should be capable of transporting more traffic than the Phoenix area will ever generate. Indeed, equipped as they are today, the competitive fiber backbone networks could handle all of U S WEST's end-user and transport traffic at less than eight percent capacity.[82]

The only real constraint on expanding service to U S WEST's customers in the near-term is the fact that competitive providers cannot provide service to "off-network" locations without building facilities to connect these sites to their fiber backbone networks. In most cases, this is not an issue at all. Approximately 65 percent of U S WEST's current high capacity demand in the Phoenix area is located within 100 feet of existing competitive provider fiber networks, which means that it

[80] Comsat Reclassification Order ¶ 78.

[81] Attachment A, Quality Strategies Report at 6, 27. Attachment D hereto is a map illustrating the existing competitive provider fiber backbone networks in the Phoenix area.

[82] Attachment A, Quality Strategies Report at 29.

is essentially located "on-network." Thus, competitive providers could absorb a majority of U S WEST's high capacity demand almost immediately, incurring only minimal costs.

Moreover, as the attached report prepared by PEI demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand. Specifically, competitive providers in Phoenix can serve the almost 50 percent of U S WEST's high capacity customer locations within 1,000 feet of their existing fiber networks – which accounts for approximately 86 percent of U S WEST's current high capacity demand in the Phoenix area – if they invest $45 million.[83] In addition, competitive providers can serve all of U S WEST's high capacity customer locations within 9,000 feet of their existing fiber networks – which accounts for more than 95 percent of U S WEST's current high capacity demand in the Phoenix area – if they invest approximately $127 million.[84] As wireless technology continues to develop, high capacity fixed wireless alternatives will provide an alternative, low cost means of expanding these competitive fiber backbone networks.[85]

To put these figures into prospective, Kahn and Tardiff observe that U S WEST's current high capacity customers generate about $50 million of revenue

[83] Attachment B, PEI Study at 3. Attachment E hereto is a map showing competitive provider coverage of U S WEST's DS1 equivalent services, including a buffer area within 1,000 feet of existing competitive provider fiber networks.

[84] Attachment B, PEI Study at 3.

[85] Id.

annually in direct charges for high capacity facilities (i.e., for the "dial tone" alone).[86] This means that, based on plausible assumptions, the investment necessary to serve all that current business would be about 2.7 times revenues – a multiple "markedly lower" than U S WEST's current investment to revenue multiple of 3.2 for Arizona.[87] The investment ratios required for competitive providers to reach those customers located within 1,000 feet of the providers' existing fiber networks would be even more favorable.[88]

The investment to revenue comparisons are somewhat hypothetical exercises for considering whether competitive providers would find it economical to expand their networks to serve U S WEST's existing high capacity demand if it were to become available.[89] As such, the comparisons do not take into account the lost economies of scale and density that competitive providers would likely experience if they expand selectively to serve high volume/low cost locations.[90] On the other hand, Kahn and Tardiff state that focusing on scale economies sacrificed by targeting customers actually understates the attractiveness of serving current U S WEST high capacity locations, for two reasons.[91] First, because the high capacity market is growing, competitive providers can realize economies of scale by

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[86] Attachment C, Kahn and Tardiff Paper at 13.

[87] Id.

[88] Id.

[89] Id.

[90] Id.

[91] Id. at 14.

serving the incremental demand in addition to demand captured from U S WEST.[92] Second, it is important to recognize that the revenue figures only reflect payments for the use of the high capacity facilities – as such, they do not take into account the fact that competition increasingly involves the provision of a package of services (i.e., one-stop shopping).[93] Competitive providers that obtain access to a customer through their high capacity business have a vehicle for obtaining access to other higher margin services. This means that competitors may be willing to underprice their high capacity services in order to "capture" the customer. Taking the net revenues from bundled services into account would make the investment to revenue comparisons "markedly more favorable" according to Kahn and Tardiff.[94]

Another important consideration in assessing supply elasticity is the timeliness with which current competitors can expand facilities to meet new demand. PEI estimates that competitive providers can serve the 50 percent of current U S WEST-served locations that are within 1,000 feet of the providers' existing fiber networks in 18 to 24 months.[95] Kahn and Tardiff find that this time frame is "very significant" and consistent with the time frame envisioned in the Merger Guidelines for determining whether prospective new investments should be counted as a competitive presence disciplining the pricing behavior of firms

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[92] Id.

[93] Id. For example, ELI's President and Chief Operating Officer Dave Sharkey stated in a news release dated May 4, 1998: "We are witnessing the success of our bundled service strategy, as nearly 60% of our customers purchased multiple products and services." PR Newswire Association, Inc., May 4, 1998.

[94] Attachment C, Kahn and Tardiff Paper at 14.

contemplating a merger.[96] Although serving those customers beyond 1,000 feet would require additional time, the competitive providers' ability to do so is "competitively significant" according to Kahn and Tardiff.[97]

The impressive growth of competitive provider's market share in the Phoenix area market for high capacity services demonstrates that the cost of entry is not prohibitive.[98] This growth is reflected in tremendous growth in the number and size of competitive providers nationwide. In addition, competitive providers have been attractive takeover targets and are having no trouble attracting large amounts of capital in the financial market. For example, ELI went public in November 1997 and raised $128 million in its equity offering.[99] Kahn and Tardiff note that, in the two years since the passage of the 1996 Act, competitive providers have raised $14 billion of outside capital, whereas total annual investment by incumbent LECs has been about $18 billion.[100]

Nor are there legal barriers to entry.[101] Competitive providers have other market entry options in those areas where they choose not to deploy facilities. With the adoption of the 1996 Act, Congress implemented a comprehensive system of

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[95] Attachment B, PEI Study at 3.

[96] Attachment C, Kahn and Tardiff Paper at 14-15

[97] Id. at 15.

[98] Id.

[99] ELI also has a $400 million credit line, guaranteed by its parent company, Citizen's Utilities, which has an A+ rating with Standard & Poors. Citizen's other securities carry ratings that range from AA- to AA+.

[100] Attachment C, Kahn and Tardiff Paper at 16-17.

[101] Compare Comsat Reclassification Order at ¶ 82.

market-opening provisions that benefit both facilities-based carriers and pure resellers. This flexibility allows competitive providers to increase their market presence through resale beyond the reach of their existing fiber networks. It also allows them to increase their market share more quickly than would be possible solely through expansion of their own networks.

5. U S WEST's Cost, Structure, Size and Resources

In the AT&T Reclassification Order, the Commission addressed the question of whether AT&T's size relative to other carriers might give it a significant advantage in terms of scale economies and access to capital.[102] U S WEST does not enjoy any such advantage in the Phoenix area market for high capacity services. While the Commission considered the fact that AT&T faced at least two "full-fledged facilities-based competitors" in the long distance market,[103] U S WEST faces five established facilities-based competitors in the Phoenix MSA. As discussed above, the combined AT&T/TCG and MCI/MFS WorldCom entities have a significant advantage in terms of scale economies and access to capital, not to mention the advantage of being able to provide interLATA services.

According to the Kahn and Tardiff Paper, the continued feasibility and vitality of competitive entry in the Phoenix area market for high capacity services is shown by the fact that the rapid expansion of competitive entry has occurred at the

[102] AT&T Reclassification Order, 11 FCC Rcd. at 3309 ¶ 73. The Commission recently held that Comsat does not have market power, notwithstanding its finding that Comsat has competitive advantages in size and access to resources. Comsat Reclassification Order ¶ 93.

[103] AT&T Reclassification Order, 11 FCC Rcd. at 3308 ¶ 70.

same time as incumbent charges for high capacity services have substantially declined.[104] In fact, when the first competitive providers entered the high capacity services market in the late-1980s, prices for high capacity services were approximately twice their current levels.[105] The fact that competitive activity in the market is accelerating while prices for services are dropping is a strong indication that investors do not believe incumbents have an insurmountable cost advantage in the market.[106]

C. U S WEST Lacks The Ability To Exercise Market Power In The Phoenix Market For High Capacity Services

The Commission has consistently held that a carrier is to be declared dominant only if it possesses market power in the relevant product and geographic market.[107] Conversely, a carrier qualifies as non-dominant if it lacks market power in the relevant market.[108] In making a determination about whether a carrier has market power, the Commission analyzes whether the carrier has the ability to "raise prices above competitive levels and maintain that price for a significant period, reduce the quality of the relevant product or service, reduce innovation or restrict output profitably."[109]

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[104] Attachment C, Kahn and Tardiff Paper at 17.

[105] Id. For example, U S WEST's rates for DS1 service fell by 43% from 1989 to 1998. Id.

[106] Id. at 17-18.

[107] AT&T Reclassification Order, 11 FCC Rcd. at 3346 ¶ 138.

[108] Id.

[109] Comsat Reclassification Order ¶ 67; see also In the Matter of The Merger of MCI Communications Corporation and British Telecommunications plc, Memorandum

Applying this standard to the evidence accumulated by U S WEST leads to the conclusion that U S WEST lacks the ability to exercise market power in the Phoenix area market for high capacity services. Following the approach the Commission previously used to assess market power for other services, Kahn and Tardiff conclude that the market for high capacity services in Phoenix "fully exhibits the indicia of competition that the Commission has prescribed."[110] In particular, Kahn and Tardiff rely on the following market characteristics: (1) U S WEST has a diminishing market share, serving only 30 percent of the retail market and providing barely half of the facilities that serve new demand; (2) customers (e.g., large businesses and other carriers) are highly sensitive to price and other service characteristics; (3) U S WEST's competitors have the ability to expand their facilities and capture U S WEST's existing business, and there are minimal barriers to entry; and (4) U S WEST's size does not provide it an insurmountable advantage.[111] In light of U S WEST's lack of market power, Kahn and Tardiff conclude that "competition itself, without dominant firm regulation, is sufficient to restrain [its] ability to impose anticompetitive prices and other conditions."[112]

Opinion and Order, 12 FCC Rcd. 15351, 15398 ¶ 124 (1997); Bell Atlantic/NYNEX Order, 12 FCC Rcd. at 20038 ¶ 101.

[110] Attachment C, Kahn and Tardiff Paper at 1.

[111] Id. at 20.

[112] Id. at 21.

III. FORBEARANCE FROM DOMINANT CARRIER REGULATION OF U S WEST IN THE PHOENIX MARKET FOR HIGH CAPACITY SERVICES IS WARRANTED

Section 10 of the 1996 Act requires that the Commission "forbear from applying any regulation or any provision of this [Act] to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services, in any or some of its or their geographic markets" if the Commission finds that:

> (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;[113]
>
> (2) enforcement of such regulation or provision is not necessary for the protection of consumers;[114] and
>
> (3) forbearance from applying such provision or regulation is consistent with the public interest.[115]

In making the public interest determination, Section 10 requires that the Commission consider whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services.[116]

Based on the compelling economic evidence of the preceding section, U S WEST requests that the Commission forbear from regulating it as a dominant

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[113] 47 U.S.C. § 160(a)(1).

[114] 47 U.S.C. § 160(a)(2).

[115] 47 U.S.C. § 160(a)(3).

[116] 47 U.S.C. § 160(b).

carrier in the Phoenix area market for high capacity services. In particular, U S WEST seeks forbearance from the following Commission regulations: (1) the requirement that incumbent LECs (but not providers other than incumbent LECs) must file tariffs for interstate access services;[117] (2) Sections 61.38 and 61.41-61.49, which require dominant carriers to file tariffs on up to 15-days notice with cost support;[118] (3) Section 69.3(e)(7), which requires averaged rates within a study area;[119] (4) Sections 61.41-61.49, and 65, which impose price cap and rate of return regulation on dominant carriers;[120] and (5) any other rules that apply to U S WEST, but not other providers, in the Phoenix area market for high capacity services.

A. Dominant Carrier Regulation Of U S WEST's High Capacity Services In Phoenix Is Not Necessary To Ensure That Rates And Practices Are Just, Reasonable, And Not Unreasonably Discriminatory

The first statutory criterion for forbearance requires that the Commission determine whether dominant carrier regulation of U S WEST's high capacity services in the Phoenix MSA is necessary to ensure that rates and practices are just, reasonable and not unreasonably discriminatory. As the Commission recognized, it is "highly unlikely" that carriers lacking market power could successfully charge rates that violate the Act, because an attempt to do so would

[117] See CAP Forbearance Order, 12 FCC Rcd. at 8596 (forbearing from requiring non-incumbent LEC providers of exchange access services to file tariffs).

[118] 47 C.F.R. §§ 61.38, 61.41-61.49.

[119] 47 C.F.R. § 69.3(e)(7).

[120] 47 C.F.R. §§ 61.41-61.49, 47 C.F.R. § 65.

prompt customers to switch to different carriers.[121] For that reason, the Commission has determined that tariffing is not necessary to ensure reasonable rates for carriers that lack market power.[122] In this case, the market for high capacity services in the Phoenix MSA is sufficiently competitive that there is no reason to regulate any carrier as dominant.

In the preceding section, U S WEST demonstrated that it does not possess market power in the Phoenix area market for high capacity services. Therefore, it should not be required to file dominant carrier tariffs and comply with other dominant carrier regulations, such as the rate averaging requirement. Rather, as is the case for every other non-dominant carrier in the high capacity market, U S WEST should be subject to permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of lawfulness and without any cost support.[123] Marketplace forces will effectively preclude U S WEST from charging unreasonable rates for high capacity services in the Phoenix MSA.

Moreover, other regulations are sufficient to ensure that U S WEST does not

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[121] PCIA Forbearance Order ¶ 57 (citing CAP Forbearance Order, 12 FCC Rcd. at 8608 ¶ 23; In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order, 11 FCC Rcd. 20730, 20742-47 ¶¶ 21-28 (1996) ("IXC Forbearance Order")).

[122] CAP Forbearance Order, 12 FCC Rcd. at 8608 ¶ 23; IXC Forbearance Order, 11 FCC Rcd. at 20742-43 ¶ 21.

[123] CAP Forbearance Order, 12 FCC Rcd. at 8610 ¶ 27. It should be noted that the Commission tentatively concluded that it should adopt mandatory detariffing for interstate exchange access services, as it previously adopted for interexchange services. Id. at 8613 ¶ 34.

attempt to charge unreasonable rates. In particular, Sections 201 and 202 of the Act require that rates and practices be just, reasonable, and not unreasonably discriminatory.[124] The Commission can address any issue of unlawful rates or practices through the exercise of its authority to investigate and adjudicate complaints under Section 208.[125] As the Commission recently noted, Sections 201 and 202 provide important safeguards for consumers in areas that have been deregulated by the Commission.[126] In those circumstances where the Commission has reclassified carriers as non-dominant because they lack market power and reduced those carriers' regulatory burden, the Commission has continued to require compliance with Sections 201 and 202.[127]

It is also important to recognize that U S WEST is not seeking to impose restrictions on the resale of its high capacity facilities. The Commission has recognized that resellers exert downward pressure on rates through their ability to purchase service at high volume rates and pass through those savings to their customers.[128] In the Phoenix area market for high capacity services, where competitive providers already have captured 70 percent of the retail market segment, resellers clearly have the ability to exert such pressure. Thus, grant of U S WEST's Petition would not weaken the market forces that restrain U S WEST's

[124] 47 U.S.C. §§ 201(b), 202(a).

[125] 47 U.S.C. § 208(a).

[126] PCIA Forbearance Order ¶ 31.

[127] Id. ¶ 17.

[128] Id. ¶ 35.

ability to charge unreasonable rates.

B. Dominant Carrier Regulation Of U S WEST's Dedicated High Capacity Services In Phoenix Is Not Necessary To Protect Consumers

The second statutory criterion for forbearance requires that the Commission determine whether dominant carrier regulation of U S WEST's high capacity services in Phoenix is necessary for the protection of consumers. As demonstrated in the previous section, dominant carrier regulation is not necessary to assure that U S WEST's rates and practices are just, reasonable and not unreasonably discriminatory. Because U S WEST lacks market power, rates for high capacity services will be effectively constrained by market forces. Further, the requirements of Sections 201 and 202 serve as an additional safeguard for consumers. Therefore, dominant carrier regulation of U S WEST also is not necessary to protect high capacity consumers from unreasonable rates or discriminatory practices. In fact, high capacity customers are being deprived of many of the benefits of competition in the Phoenix area market for high capacity services because of the continued regulation of U S WEST as a dominant carrier. Accordingly, the second criterion is satisfied.[129]

C. Forbearance From Applying Dominant Carrier Regulation To U S WEST's High Capacity Services In Phoenix Is Consistent With The Public Interest

The third statutory criterion for forbearance requires that the Commission determine whether forbearance from applying dominant carrier regulation to U S WEST's high capacity services in the Phoenix MSA is consistent with the public

[129] Id. ¶ 58; CAP Forbearance Order, 12 FCC Rcd. at 8609-10 ¶ 26.

interest. In making this public interest determination, the Commission considers whether forbearance will "promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services."[130] Continuing to regulate U S WEST as a dominant carrier in the Phoenix area market for high capacity services results in competitive distortions that do not serve the public interest.

In the AT&T Reclassification Order, the Commission graphically described the significant social costs of continued asymmetrical regulation: (1) the longer tariff notices imposed on AT&T dampened its incentives to innovate because rivals could respond to innovations before they were allowed to go into effect; (2) the tariff filing requirements also dampened AT&T's incentives to reduce prices; (3) AT&T's competitors could use the asymmetrical regulatory process to delay and undermine its initiatives; and (4) regulation imposed administrative costs on both AT&T and the Commission.[131]

Kahn and Tardiff conclude that dominant carrier regulation of U S WEST in the Phoenix market for high capacity services market involves the same kinds of social costs.[132] The 15-day tariff notice requirement, which applies only to U S WEST, gives competitive providers the opportunity to respond to U S WEST's

[130] Comsat Reclassification Order ¶ 151; see also PCIA Forbearance Order ¶ 27.

[131] Attachment C, Kahn and Tardiff Paper at 18 (citing AT&T Reclassification Order at ¶ 32); see also PCIA Forbearance Order at ¶ 30 (Forbearance with regard to broadband PCS carriers alone would create regulatory asymmetry with respect to cellular and other CMRS providers that would "distort competition and contradict the intent of Congress that CMRS providers should be treated similarly.")

[132] Attachment C, Kahn and Tardiff Paper at 18.